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C O N F I D E N T I A L SECTION 01 OF 03 SANAA 001511

SIPDIS

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TAGS: [EPET](#) [ECON](#) [EINV](#) [YM](#) [ECON](#) [COM](#) [ENERGY](#)

SUBJECT: SEARCH FOR BLOCK 18 SOLUTION: HUNT ASKS AMBASSADOR TO INTERVENE

REF: A. SANAA 1281

[1](#)B. SANAA 1352

Classified By: Ambassador Thomas C. Krajeski for reasons 1.5 b and d.

[1](#)1. (U) This is an action request. See para. 3

[1](#)2. (C) Summary and Action Request. Tensions continue to mount over Block 18 and Yemen Hunt's future in Yemen. On May 24 Ambassador met a group of Hunt executives preparing to litigate in international court for ROYG breach of contract (ref A). Although still looking to strike a deal, Hunt is increasingly pessimistic about its ability to influence President Saleh. Hunt's legal advisors believe they have a strong case and an international reputation to maintain. Parliamentary sources contend that the legislature is flexing its muscle in a legitimate attempt to crack down on corruption and that following last year's oil scandals, Saleh is not in a position to impose his will on Parliament. Saleh is reportedly willing to sign a new contract with Hunt for a higher ROYG profit share, but the parameters of such agreement are still unknown. On June 3, Hunt formally requested Ambassador to weigh in with President Saleh to find a solution. Post seeks guidance from NEA/ARPI on Hunt's request and has provided suggested talking points below. See para. 3. End summary and action request.

Hunt asks Ambassador to Intervene with Saleh

[1](#)3. (C) On June 3 Hunt formally requested the Ambassador to weigh in with President Saleh to "defend the sanctity of the five-year extension of the Maarib PSA" granted in late 2003. Post requests guidance on Hunt's request for the Ambassador to meet with Saleh in support of Hunt.

Suggested talking points:

-- We are very concerned that Hunt, the major American company in Yemen, will be forced to leave at a time when the ROYG has made improving its investment climate a major tenet of economic reform.
-- Understand the legal issues are complex but Hunt's claim appears valid.
-- Hunt has stated its intention to take this issue to the Public International Court in Paris. Litigation promises to be a costly and lengthy legal battle, with negative implications for Yemen's image among international investors.
-- Block 18 is critical to Yemen's revenue, both for oil and LNG. It is important that reputable international companies such as Hunt manage these projects.

Hunt Prepares for Battle

[1](#)4. (C) Ambassador met May 24 with Yemen Hunt representatives for continued discussion regarding the American oil company's Block 18 extension. Hunt executives included Vice President and General Manager Wendell Caviness, post's regular interlocutor, joined by Senior VP Tom Meurer, Senior VP and General Counsel Dennis Grindinger, and Karim Abu Hamad, General Manager of Yemen Hunt LNG Co. Hunt maintains it intends to take Yemen to the Paris Public International Court, as outlined in the Production Sharing Agreement (PSA). Company lawyers are confident they can prevail in court by charging that the ROYG violated the sanctity of Hunt's contract with the Ministry of Oil (MOO). In Hunt's view, Parliament did not have the authority to reject the PSA extension, only to ratify or reject specific terms of the agreement. Meurer explained that Hunt will not seek injunctive relief for Block 18 revenues if it goes to court, but will claim for damages based on a price of USD 50 per barrel. The Government will have to find someone else to operate Block 18, said Meurer. "Once it goes to court, we're out."

"Stop the Train Wreck"

[1](#)5. (C) Hunt is looking for assistance to "stop the train wreck," said Meurer. Hunt's usual ROYG contacts, Minister of Oil Baraba and Presidential Advisor al-Iryani, appear no

longer to have the President's ear (ref B). During April talks with al-Iryani, confided Meurer, both sides reached a compromise in which Hunt would keep the existing production area and return the remainder of Block 18 to the ROYG. The ROYG would then reimburse Hunt for exploration and investment costs. The President, however, was reportedly unmoved by this proposal. Nevertheless, this week a contact close to Saleh maintained that the President is indeed ready to deal, reporting that Saleh wants to draw up an entirely new contract with a higher profit share for the ROYG. Ambassador offered to engage Saleh directly on the matter, and on June 3 Hunt accepted the offer.

Block 18 Debated in the Media

16. (C) The Hunt negotiations have recently received extensive and varied coverage in the press. Caviness acknowledged that Hunt leaked its letter to MOO protesting the Block 18 decision (ref A). Government newspaper al-Thawra reported that Prime Minister Bajammal made overtures to Hunt in a May 25 meeting. Bajammal stated that the ROYG would shift from a PSA arrangement to an operations contract, but that Hunt would be given priority in the selection process. (Note: Hunt indicated that it would only accept a PSA agreement, which provides more extensive guarantees for foreign investors. With an operating contract, the Government retains full ownership over the Block, and has greater freedom to alter terms in the agreement. End note.) In contrast, the English language newspaper Yemen Observer blasted Hunt, saying the company was suing Yemen for USD 7 billion (denied by Hunt) and leveling multiple accusations at Hunt relating to the extension agreement.

Hunt Rubs Parliament the Wrong Way

17. (C) According to MP Mohamed Al-Shaddi and former MP Dr. Saadaldeen Talib, Hunt's letter was a tactical mistake (ref A). Parliament believed that because the extension included amendments to the original PSA, MPs have a constitutional right to vote on the matter. By denying this, Hunt aroused the ire of independent-minded MPs who believed that Hunt was violating Yemen's sovereignty. Following last year's scandal surrounding Block 53, contended Talib, oil is the one area where Parliament seems to have some real leverage over the executive. Al-Shaddi agreed, saying the scandal tarnished the President's reputation and he is loath to repeat the experience. Talib feels that Hunt tragically misread Yemeni politics and the role of Parliament in this affair. Because Hunt's letter mentions Parliament by name, it was formally presented to MPs by Bajammal, thereby forcing the legislature to respond to the allegations and making any potential deal more difficult.

18. (C) Hunt executives believe that much of Parliament's opposition is due to personal vendettas against the American company. For example, said Meurer, Abdul Khader Thabet, Chairman of the Economic and Petroleum Affairs Committee and one of the extension's main opponents, recently lost a trucking contract with Hunt. Meurer also accused Hamid al-Ahmar, powerful MP and son of Parliamentary Speaker Sheikh Abdullah al-Ahmar, of attempting to squeeze out Hunt so he could operate Block 18 in partnership with a Saudi company. Talib disagreed, saying the issue is much too sensitive for Thabet to exert such influence. It is more likely, he said, that Saleh himself was not satisfied with the deal negotiated by the MOO and gave Parliament the green light to shoot it down. Al-Shaddi said that all MPs believe the MOO to be a sacrificial lamb in this struggle, offered up so that Saleh can appear tough on oil corruption.

19. (C) The corruption is real, argued Talib, pointing out that Parliament's report issued before the extension vote was based on MOO numbers that showed Hunt would receive 15 USD per barrel while a fresh operator could do the job for only 2 USD per barrel. At a low estimate of 40 USD per barrel, said Talib, the ROYG stood to lose 1 billion USD. The inclusion of the shady Crest Company as a third partner, continued Talib, smacked of corruption similar to that in the Block 53 scandal. In that case, ROYG officials and oil companies agreed to undersell crude to a third party and then distribute profits derived from the market prices to unnamed partners.

Oil Spills Over to Gas

10. (C) Adding fuel to the fire, the Block 18 debate is influencing the still pending Liquid Natural Gas (LNG) agreement. Grindinger said that with LNG Yemen has the opportunity to move investment to a new level. The ROYG stands to benefit from equity, taxes, and royalties derived from 6.7 million tons of natural gas extracted per year,

"This could be a twenty year cash machine for the Government," said Grindinger. However, the project depends on USD 3 billion up front, half of which will need to be borrowed, and capital could prove hard to secure if the Block 18 extension ends up in international court. Hunt is preparing its case, "to drive a stake in the heart of the Government's ability to contract," said the Hunt council. AbuHamad contended that a high profile case would damage the ROYG's international commercial reputation. Coupled with ongoing security concerns, this would level a crushing blow to financing efforts for the LNG deal.

11. (C) As the LNG agreement reaches the finish line, rumors abound that the LNG deal is going the way of Block 18. Parliament recently raised objections similar to those in the Hunt debate, saying that French company Total was issued three "unconstitutional" extensions without review by Parliament, and that prices were fixed below market value in collusion with Total and the South Korean Kogas Company. According to AbuHamad, Deputy Prime Minister Ahmed Sofan wants to reserve natural gas for domestic use in order to meet Yemen's domestic energy deficit, a sentiment echoed by Parliament's Petroleum Committee. The Committee ordered further study and recommended halting any further measures pending a full review.

Saleh Between Hunt and a Hard Place

12. (C) Comment: Hunt takes great pains to advance its image as an honest dealer in Yemen, contrasting itself with other foreign companies who regularly pay bribes to ROYG officials and private parties. In the case of the Block 18 expansion, however, Hunt may have been caught with its pants down. It seems clear that Hunt got a sweetheart deal from MOO, and in exchange agreed to give the little-known Crest a healthy share of profits. Having just drawn blood from the executive in the Block 53 scandal, Parliament set its sights on the Hunt extension. By revealing price fixing schemes, Parliament identified an oft-used means of embezzlement among Yemen's elite. MPs have essentially accused foreign companies of colluding with their own corrupt government officials.

13. (C) Comment Continued. By repeatedly dismissing Parliament's authority, Hunt angered MPs, increasing their resolve to attack the PSA extension. This is not to imply that Hunt's legal case is invalid, but rather that litigation could be a disaster for all parties. Without a deal, Hunt will be forced to abandon Block 18 and Yemen's investment climate will be seriously damaged. As joint investors in the LNG venture, both sides stand to lose considerable profits. Despite tough words, Hunt is still willing to negotiate, but time is running for all sides. President Saleh, as always the deciding factor, is currently caught between Parliament's anti-corruption fervor and the expediency of a deal with Hunt. It is likely that he will push for a new deal, but it remains unclear by what mechanism both Hunt and Parliament can be appeased. End comment.
Krajeski